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STATE OF ALASKA

BEFORE THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Keith Kurber II, Chair
Robert A. Doyle
John M. Espindola
Robert M. Pickett
Janis W. Wilson

In the Matter of the Consideration of the Revenue Requirement Designated as TA 334-4 Filed by ENSTAR NATURAL GAS COMPANY, A DIVISION OF SEMCO ENERGY, INC.	)))))	Docket No. U-22-081

PREFILED REPLY TESTIMONY
OF
HAROLD WALKER, III

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I. INTRODUCTION, PURPOSE, AND SUMMARY

Q. Are you the same Harold Walker, III who previously submitted direct testimony in this proceeding?

A. Yes. For the Commissioners' and the parties' convenience, the short-hand references, including acronyms used in this Prefiled Reply Testimony, have the same meaning as in my Prefiled Direct Testimony.

Q. What is the purpose of your Prefiled Reply Testimony?

A. The purpose of my testimony is to reply to the responsive testimonies submitted by Homer Electric Association, Inc. and Alaska Electric and Energy Cooperative, Inc. (collectively, "HEA") witness Catherine E. Palazzari and the Office of the Attorney General, Regulatory Affairs and Public Advocacy Section ("RAPA") witness Ralph C. Smith as they relate to their calculations of the appropriate cash working capital ("CWC") allowances for inclusion in ENSTAR's rate base in this proceeding before the Regulatory Commission of Alaska ("Commission").

Q. In connection with your Prefiled Reply Testimony, have you updated Schedule HW-1, which was included within Exhibit HW-2 to your Prefiled Direct Testimony?

A. Yes. In my Exhibit HW-3 to this Prefiled Reply Testimony, I have prepared Updated Schedule HW-1 which reflects the Company's agreement to recommended changes to the Company's test year classification of earthquake amortization. Specifically, the Company agreed with RAPA to reclassify earthquake amortization in depreciation expense instead of administrative and general expenses as explained in the Prefiled Reply Testimony of ENSTAR witness Ms. Chelsea Guintu.

Q. Are there any areas of agreement in the CWC testimonies presented in this proceeding?

A. Yes, both Ms. Palazzari and Mr. Smith adopt the majority of the lead-lag days used in my Prefiled Direct Testimony.

Q. Please summarize the areas of disagreement between your Prefiled Direct Testimony and the testimonies from Ms. Palazzari and Mr. Smith that you will address in this Prefiled Reply Testimony.

A. Ms. Palazzari's testimony differs from mine in four primary areas: (1) she adjusts the payroll expenses lead days by modifying the lead days for salary and wage expenses, 401k matching expense, and adding pension expense; (2) she removes affiliate charges; (3) she adjusts the lead days for ad valorem taxes; and (4) she excludes depreciation expenses and operating income from her CWC determination.

Mr. Smith's testimony differs from my testimony in four primary areas: (1) he adjusts the revenue lag days by changing the revenue billing lag days; (2) he removes cash generating cost of service items such as uncollectible expense, depreciation expense, deferred taxes, and utility operating income for the Company; (3) he adjusts the lead days for ad valorem taxes; and (4) he adds lead days for interest expense to his CWC determination. Mr. Smith's testimony also differs from my testimony in that he used RAPA's adjustments to the Company's cost of service to determine his CWC allowance.

I will address these areas of disagreement in the remainder of my Prefiled Reply Testimony.

II. REVENUE LAG-DAYS ADJUSTMENTS

Q. Does HEA recommend adjusting ENSTAR's revenue lag days?

A. No. Ms. Palazzari does not recommend adjusting ENSTAR's revenue lag days.

Q. Does RAPA recommend adjusting ENSTAR's revenue lag days?

A. Yes, on pages 31 - 33 of his testimony, Mr. Smith recommends adjusting, or reducing, ENSTAR's revenue lag days. Specifically, Mr. Smith recommends reducing ENSTAR's revenue billing lag days from 4.3 days to 1.6 days.

Q. How are revenue lag days determined?

A. Revenue lag days are calculated as part of a lead-lag study. Revenue lag days are calculated by summing or adding three distinct components together. The three components that comprise the revenue lag days are the service period lag days, the billing lag days, and the collection lag days.

Q. What are revenue billing lag days, and how did you determine them for ENSTAR?

A. A revenue billing lag day is the time from the meter reading date to the date the customer is billed. On the customer billing date, the bill is mailed to the customer, and the total billing amount for the cycle is recorded to ENSTAR's accounts receivable. I calculated ENSTAR's billing lag days in the course of conducting a lead-lag study which encompassed billing data for the twelve months ended December 31, 2021. The results of the lead-lag study determined that ENSTAR's billing lag days are 4.3 days.

Q. Did Mr. Smith conduct a lead-lag study to determine his recommended 1.6 days revenue billing lag?

A. No.

Q. What is the basis for Mr. Smith's recommended 1.6 days billing lag?

A. Mr. Smith recommends using the same revenue billing lag days determined in

ENSTAR's last rate case.

Q. Did Mr. Smith conduct a lead-lag study of the revenue billing lag days in ENSTAR's last rate case?

A. No.

Q. How were ENSTAR's revenue billing lag days determined in its last rate case?

A. I was not involved in the Company's last rate case. However, it is my understanding that another consultant was engaged by ENSTAR and that he determined the billing lag days were 1.6 days based upon data for the twelve months ended December 31, 2015.

Q. For this case, does Mr. Smith recommend using all the lag days and/or lead days determined in ENSTAR's last rate case?

A. No. Mr. Smith only recommends using the revenue billing lag days determined in ENSTAR's last rate case. Besides the revenue billing lag days, Mr. Smith does not recommend using any other lag day or lead day determined in ENSTAR's last rate case.

Q. Previously you stated the lead-lag study that you conducted for this case is based on data from 2021, and the lead-lag study conducted for ENSTAR's last rate case was based on data from 2015. Is it unusual for lag days and/or lead days to change if they are based on data from different time periods?

A. No. Lag days and lead days are dependent on the time period used in the study. This is especially true when looking at data from time periods that are six years apart. Operations for companies change over time, as do costs, which is the very reason why it is inappropriate to cherry pick data from one case based on a specific time period for use in another case. For this reason, regulatory commissions typically require new lead-lag studies based on the test year for each rate filing application as the basis for the revenue requirement, as ENSTAR was required to do in Order U-16-066(19).

Q. Do you agree with Mr. Smith's rationale for using a revenue billing lag of 1.6 days?

A. No. On page 32 of his testimony, Mr. Smith states his belief that the revenue billing lag "is one of the elements of operating a utility that is under the control of utility management." However, Mr. Smith did not consider the impact that a worldwide pandemic might have on a revenue billing lag day. He did not consider the possibility that a revenue billing lag day from 2015 might be an outlier in terms of achievable results or that it may have been based on incorrect data. He did not consider that changes in software, accounting procedures, or operating procedures that produce savings elsewhere may impact revenue billing lag. He did not consider that expense billing lead days may have similarly changed as revenue billing lag days have changed. Simply put, Mr. Smith did not consider that things often change, especially over a six-year period.

Q. What are expense billing lead days?

A. An expense billing lead day is similar to a revenue billing lag day except it relates to expenses. For example, an expense billing lead day for ENSTAR is the amount of time (days) from the last day that a vendor provided a service for ENSTAR to the date the vendor billed or invoiced ENSTAR.

Q. Does Mr. Smith recommend adjusting the expense billing lead days for any of ENSTAR's expense item lead days?

A. No. Mr. Smith only recommends adjusting revenue billing lag days but is silent regarding expense billing lead days.

Q. Did Mr. Smith find any errors in the revenue billing lag day analysis used in your lead-lag study?

A. No.

Q. Do you have any other comments regarding Mr. Smith's recommended adjustment to ENSTAR's revenue billing lag days?

A. Yes. Order U-16-066(19) in ENSTAR's last rate case required ENSTAR to conduct a lead-lag study in support of its CWC requirement in its next rate case. ENSTAR's CWC requirement requested in this case is based on a lead-lag study. A lead-lag study is an accurate and appropriate method of determining CWC because it provides a mathematical picture of the utility's CWC situation, whether large or small. However, lead-lag studies are more costly than other methods of determining CWC. If hypothetical billing lag days are allowed in lieu of the results of a lead-lag study, it defeats the purpose of conducting a lead-lag study and here results in nothing more than the arbitrary confiscation of investor-provided capital. The Commission should not accept Mr. Smith's adjustment to ENSTAR's revenue billing lag days.

III. EXPENSE LEAD DAYS ADJUSTMENTS

A. PURCHASED GAS COSTS

Q. Does HEA recommend adjusting ENSTAR's purchased gas costs lead days?

A. No. However, on page 58 of her testimony, Ms. Palazzari disputes who should pay for the purchased gas CWC requirements. If one were to address Ms. Palazzari's suggestion, then it would be best handled as part of the allocation process. The lead-lag study that I conducted was done on a total company basis. I do not believe sufficient data exists to calculate separate lead-lag studies for each discrete rate class. To do so would require the three revenue lag day components to be separated by customer class and for each expense lead day line item (not just purchased gas cash cost) to be separated by customer class.

B. PAYROLL EXPENSES

Q. Does HEA recommend adjusting ENSTAR's payroll expense lead days?

A. Yes. Ms. Palazzari recommends adjusting the lead days for some of the components of payroll expense. ENSTAR's payroll expense lead days calculation is comprised of four components: salary and wage expenses; 401k matching expense; Federal payroll taxes; and State payroll taxes. Ms. Palazzari recommends adjusting the lead days for salary and wage expenses and 401k matching expense. Additionally, Ms. Palazzari added pension expense lead days to her payroll expense lead days adjustments.

Q. Do you agree with HEA's recommended adjustments to ENSTAR's salary and wage expenses lead days?

A. No. On pages 59 and 60 of her testimony, Ms. Palazzari explains that her adjustment to salary and wage expenses lead days is due to the payment date for non-union bonus occurring **earlier** than the date used in my lead-lag study. On page 59, Ms. Palazzari states, "Mr. Walker's computation of non-union bonus lead days shows the non-union bonus payment as occurring on February 26, 2021." However, there is a typographical error in the description of the line item on Schedule HW-6 of Exhibit HW-2 to my Prefiled Direct Testimony, which incorrectly states "2/26/21," whereas the excel workpaper, and the mathematical computation itself, are based on a payment date of "3/26/21" (i.e., the 267.5 lead days shown on Schedule HW-6 is based on payment date of 3/26/21).

Then, on page 60, Ms. Palazzari states that she recalculated the lead days to be 280.5 days for the non-union bonus using a date of March 12, 2021, "because the majority of non-union bonus payments occurred on March 12, 2021 according to data provided in discovery by ENSTAR." However, if Ms. Palazzari used a payment date of March 12, 2021, in her calculation, that calculation would have resulted in 253.5 days, not the 280.5 days stated in her testimony.[1]

Because the Company's lead-lag study used a payment date for non-union bonus of March 26, 2021 and calculated lead days of 267.5, if one were to use Ms. Palazzari's payment date of March 12, 2021, it actually **lowers** the non-union bonus lead days from 267.5 to 253.5 days. Further, factoring Ms. Palazzari's payment date for non-union bonus into the Company's calculation of salary and wage expenses lead days **lowers** the salary and wage expenses lead days from 28.9 days to 27.9 days and **lowers** the Company's payroll expenses lead days from 34.0 to 33.2 days. Using a payroll expenses lead of 33.2 days **increases** the Company's CWC by $38,582 and results in a CWC of $9,873,264.

Q. Do you agree with HEA's recommended adjustments to ENSTAR's 401k matching expense lead days?

A. No. ENSTAR pays its payroll-related obligations, including 401k matching, on each employee pay date. Therefore, the correct payment date for 401k matching is the employee pay date — the date ENSTAR disburses payment. Ms. Palazzari's discussion, on page 60 of her testimony, on 401k matching trust payment dates is based

[1] Mathematically, 3/12/21 - 7/1/20 = 253.5 days; where 7/1/20 = (1/1/20 + 12/31/20) ÷ 2.

on a misunderstanding that ENSTAR pays 401k matching separately from other payroll-related obligations, which is not the case.

Q. Do you agree with HEA's recommended adjustments to ENSTAR's payroll expense for pension expense lead days?

A. No, for several reasons. First, ENSTAR's payroll expense does not include pension expense. Rather, pension expense is part of the affiliate charges line item and therefore, should not be included in the payroll expense lead days calculation proposed by Ms. Palazzari. Second, Ms. Palazzari provided no definitive payment dates in 2021 for her assumed 183-day pension lead days, shown on page 62 of her testimony, which suggests her assumed 183-day pension lead day is a hypothetical lead day not based on an actual payment date. Third, in footnote number eight on page 61 of her testimony, Ms. Palazzari states the pension was overfunded in 2021 (i.e., negative), but this indicates that no payments would have occurred in 2021 and thus, there would be no lead days associated with pension for purposes of the lead-lag study. The Company has confirmed there were no contributions to the pension plan in 2021, making Ms. Palazzari's suggested change irrelevant because the lead-lag study is based on 2021 data.

Q. Does RAPA recommend adjusting ENSTAR's payroll expense lead days?

A. No.

C. AFFILIATE CHARGES

Q. Does HEA recommend adjusting ENSTAR's affiliate charges expense lead days?

A. Yes. On pages 63 - 64 of her testimony, Ms. Palazzari recommends eliminating affiliate charges expense lead days because "ENSTAR's ratepayers should not be asked to pay CWC on cash paid from ENSTAR to the affiliate as a part of normal cash management practices when that cash is subsequently held by its corporate parent for future long term cash payment obligations."

Q. Is the cash paid by ENSTAR for affiliate charges "subsequently held by its corporate parent for future long term cash payment obligations" as claimed by HEA?

A. No. During the test year, ENSTAR paid affiliate charges in the same month the affiliate paid for the expense charged to ENSTAR. In fact, the affiliate made payment to the vendor and was then subsequently paid by ENSTAR. There is no nefarious "holding of cash" as suggested by Ms. Palazzari.

Q. Is HEA consistent with its recommended elimination of affiliate charges?

A. No. Ms. Palazzari moved pension expense from affiliated charges to include it as part of her recommended payroll expense lead days but then recommended eliminating the affiliated charges line item. If affiliated charges are to be eliminated, then pension expense must also be eliminated because it is part of affiliated charges.

Q. Does RAPA recommend adjusting ENSTAR's affiliated charges expense lead days?

A. No.

D. UNCOLLECTIBLE ACCOUNTS EXPENSE

Q. Does RAPA recommend adjusting ENSTAR's uncollectible accounts expense lead days?

A. Yes. Mr. Smith recommends removing the uncollectible accounts expense line item from the determination of the Company's CWC under the pretense that it is a "non-cash expense." On page 23 of his testimony, Mr. Smith states, "[n]on-cash expenses do not involve the payment of cash, and are therefore appropriately excluded from the calculation of the cash working capital allowance."

The term "non-cash expense" is an accounting term only. It is not a term that has significance from a financial, economic, or regulatory perspective, because something categorized as a "non-cash expense" from an accounting perspective still represents a true expense for a company. Although a company does not write a check to pay uncollectible account expenses, the uncollectible expense only arises due to customers not paying for previous service provided by the company. When a customer does not pay for the cost of service, it ultimately affects the cash position of the company – a company does not recover the cost of providing customers services and therefore must finance the cost of providing for uncollected customers' services.

On page 30 of his testimony, Mr. Smith explains,

> Uncollectibles expense does not involve a cash payment by the utility. Rather, uncollectibles expense is included in the utility's cost of service and the utility's customers that pay their bills effectively pay the utility for the portion of the cost of service that is not paid for by customers that do not pay their utility bills in full.

Mr. Smith's above-cited explanation overstates the Company's position because it suggests the Company's CWC requirement is required to finance the <u>entire</u> amount of uncollectible expense, which is not the case. In fact, the Company CWC requirement shows, mathematically, that it is only financing 11.7% (42.8 days ÷ 365 days) of the entire uncollectible expense, given that customers have not yet been billed for and have not yet paid for this portion (as evidenced by the existence of a 42.8-day revenue lag based on the lead-lag study).

Accountants show some portion of "non-cash expense" line items as sources of cash on a Statement of Cash Flows contained in financial statements they prepare.[2] However, the portion of the "non-cash expense" items that customers have not yet been billed nor paid for (e.g., 42.8 days) would not be included as a source of cash on a Statement of Cash Flows because you cannot have a source of cash that you never collected due to the 42.8-day revenue lag.

If "non-cash expense" line items are not considered a CWC requirement, then it implies a company would not be impacted if they did not collect that portion of their cost of service comprised of "non-cash expense" line items. Obviously, the collection of the entire cost of service is essential to the operations of a company, otherwise "non-cash expense" items would not be included in the determination of a company's cost of service.

Q. Does HEA recommend adjusting ENSTAR's uncollectible accounts expense lead days?

A. No.

E. DEFERRED FEDERAL INCOME TAXES

Q. Does RAPA recommend adjusting ENSTAR's deferred federal income taxes lead days?

A. Yes. Mr. Smith recommends removing the deferred federal income taxes line item from the Company's CWC because he considers it to be a "non-cash expense." On page 27 of his testimony, Mr. Smith explains,

> [D]eferred income tax expenses do not involve cash payments and are accumulated in a balance sheet account, Accumulated Deferred Income Taxes ("ADIT"). To the extent that components of the utility's ADIT

[2] A Statement of Cash Flows reports many items including repayment of long-term debt, repayment of short-term debt, redemption of common stock, redemption of preferred stock and dividend payments that must be funded with funds that are provided by investors to provide service to the customers.

> balances, such as the use of accelerated federal income tax depreciation, are directly related to the utility's provision of utility service, those portions of the ADIT balance are typically reflected in rate base, based on the utility's related balance sheet amounts.

The reason for including deferred federal income taxes in a proper lead-lag study is to account for the portion (i.e., 11.7%) of deferred federal income tax expense that has not been collected or paid for by customers.[3] Specifically, deferred federal income taxes, or ADIT, are subtracted from net plant in the determination of rate base under the premise that they are "cost free capital" provided by customers **when customers pay their bills**. However, the Company collects cash associated with its deferred tax liability from customers in the same way it collects all other revenues, with a revenue lag of 42.8 days.

Given that the Company's revenues are subject to a revenue lag of 42.8 days, this means that at any point in time, the amount of deferred taxes (ADIT) that is subtracted when determining rate base is overstated because it is recorded using accrual accounting, while the full cash amount (cash accounting) has yet to be collected, because, like all other revenues, it remains uncollected from customers for 42.8 days. Excluding deferred taxes from the CWC calculation, as Mr. Smith proposes, ignores the lag between the Company's recorded deferred tax amount and its cash collection of that amount from customers. The situation begs the question: If 11.7% (42.8 days ÷ 365 days) of the deferred federal income tax expense has not yet been provided by customers, then who provided the 11.7% of the deferred federal income tax expense subtracted from net plant when determining rate base? The only possible answer is that

[3] 11.7% is derived from 42.8 days ÷ 365 days.

investors provide 11.7% of the deferred federal income tax expense subtracted from net plant when determining rate base, which is the reason for its inclusion in the determination of CWC.

Q. Does HEA recommend adjusting ENSTAR's deferred federal income tax lead days?

A. No.

F. AD VALOREM TAXES

Q. Are there any recommended adjustments to ENSTAR's ad valorem taxes lead days?

A. Yes. Ms. Palazzari recommends ad valorem taxes lead days of 65.9 days and Mr. Smith recommends lead days of 37.23 days, while the Company's lead-lag study determined the ad valorem taxes lead days of -21.5 days.

Q. Why are there differences in the recommended ad valorem taxes lead days?

A. The difference in the recommended ad valorem taxes lead days is mainly due to a combination of misunderstandings of lead-lag studies and government finances. For a lead-lag study, the two variables determined are revenue lag days and expense lead days. Lag days and lead days are each the sum of the same three components: service, billing, and collection (payment). For ad valorem taxes, Ms. Palazzari and Mr. Smith used the incorrect service component.

The service component is the period of time the service is provided for, on which payment (collection) is based. An example of a revenue service component is when gas service is provided for 30 days, payment is due for those 30 days of gas service. Similarly, an example for an expenses service component is when rental service will be provided for the next 30 days, payment is due before the start of those 30 days of rental service.

For ad valorem taxes, the service period is defined by each municipal taxing body based on the mill rate determined annually as part of their fiscal budget process for future services to be provided during their upcoming fiscal year. Accordingly, an ad valorem tax (based on a mill rate) is payment for a service *to be provided* during each municipality's fiscal year.

An ad valorem tax is usually not a payment for a service previously provided, nor is it based on calendar year services. Generally, a local government collects taxes before providing a service because it has no other means of financing the provision of service. Provision of local government service is financed through the collection of taxes, and as such, service is usually provided after taxes are collected. The service periods used by Ms. Palazzari and Mr. Smith for ad valorem taxes, however, indicate that the local governments (which collectively collected over $4.4 million ad valorem tax revenue from ENSTAR), are so flush with cash that they can operate without a current source of revenue, or on a drawdown of a cash balance that was built upon prior taxes collected. As explained above, this position defies how local government funding works.

Q. What service period should be used to determine ad valorem taxes lead days?

A. The ad valorem tax service period is the local government's budgeted fiscal year. Ms. Palazzari and Mr. Smith generally used the wrong service period in determining their ad valorem tax lead days. Ms. Palazzari, on page 1 of Exhibit CEP-14, and Mr. Smith, on page 5 of Exhibit RCS-2, both used calendar periods for their service periods, which often differs from the fiscal year.

Q. Are there other deficiencies in HEA's or RAPA's recommended ad valorem taxes lead days besides the service period?

A. Yes. Mr. Smith used the incorrect payment date. Mr. Smith used the due date for the ad valorem tax instead of the actual payment date for any tax paid before the due date as stated on page 36 of his testimony. However, Mr. Smith did not use this same approach for other expense lead days. That is, Mr. Smith did not consider a due date as the payment date for other expense lead days. Rather, for other expense line items, he used the actual payment date regardless of the due date.

G. DEPRECIATION EXPENSE

Q. Are there any recommended adjustments to ENSTAR's depreciation expense lead days?

A. Yes. Ms. Palazzari, on page 66 of her testimony, and Mr. Smith, on page 25 of his testimony, recommend removing the depreciation expense line item from the Company's CWC because they consider it to be a "non-cash expense." As with the uncollectible accounts expense discussed above, both Ms. Palazzari and Mr. Smith overstate the Company's position because they suggest the inclusion of depreciation expense indicates the Company is required to finance the entire amount of depreciation expense, which is not the case. Depreciation expense is included in a proper lead-lag study to account for the portion (i.e., 11.7%) of depreciation expense that has not been collected or paid for by customers because the Company collects cash associated with depreciation expense from customers in the same way it collects all other revenues—with a revenue lag.

Additionally, depreciation expense (accumulated depreciation) is subtracted from gross plant when rate base is determined. Therefore, at any point in time, the amount of depreciation expense (accumulated depreciation) that is subtracted when determining rate base is overstated because it is recorded using accrual accounting while the full cash amount of the expense has yet to be collected because, like all other revenues, it is uncollected from customers for 42.8 days.

On page 67 of her testimony, Ms. Palazzari refers to depreciation expense as being a source of cash reported on a Statement of Cash Flows that is contained in financial statements to support her position that depreciation is a "non-cash expense." However, Ms. Palazzari does not disclose that only a portion (e.g., 88.3%) of depreciation expense could be reported as a source of cash; the remaining portion (e.g., 11.7%) of depreciation expense that customers have not yet been billed nor paid for (e.g., 42.8 days) could not be included as a source of cash on the Statement of Cash Flows because you cannot have a source of cash that you never collected due to a 42.8-day revenue lag.

If "non-cash expense" line items are not considered a CWC requirement, then it implies a company would not be impacted if it did not collect that portion of its cost of service comprised of "non-cash expense" line items. Obviously, the collection of the entire cost-of-service is essential to the operations of a company, otherwise "non-cash expense" items would not be included in the determination of a company's cost of service.

H. OPERATING INCOME

Q. Are there any recommended adjustments to ENSTAR's operating income lead days?

A. Yes. Ms. Palazzari and Mr. Smith recommend removing the operating income line item from the Company's CWC. On pages 23 and 28 of his testimony, Mr. Smith states that operating income should be excluded because he believes it is a "non-cash expense" while also being a return on capital. On pages 68 - 70 of her testimony, Ms. Palazzari states that operating income should be excluded because she believes it is a return on capital which investors are not guaranteed, and somehow its inclusion is a claim on the time value of money.

However, the operating income, or return on invested capital, should be included in the CWC determination because operating income is the property of investors when it is earned but, like all other revenues, it is uncollected from customers for 42.8 days.[4] Mathematically, assigning zero lead days to operating income in the CWC determination recognizes the portion of the property, 11.7%, that remains uncollected. Unless investors are allowed a return on the uncollected 11.7% of operating income through the CWC requirement, they do not have an opportunity to earn a return on this investment.

[4] *Bluefield Water Works v. Public Service Comm'n*, 262 U.S. 679, 690 (1923) ("Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service of the utility to the public are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property, in violation of the Fourteenth Amendment.").

I. LONG-TERM DEBT INTEREST

Q. Are there any other recommended adjustments to ENSTAR's CWC requirement?

A. Yes. Mr. Smith improperly and inconsistently adds long-term interest expense to his CWC determination. It is improper to add interest expense to the CWC determination because interest expense is a subcomponent of the funds or the operating income that belongs to investors as previously explained, and because interest is paid from operating income. Further, Mr. Smith's inclusion of interest expense incorrectly assumes that interest expense, a subcomponent of operating income, is fully funded for payment, while its larger component, operating income, remains 11.7% uncollected due to a 42.8-day revenue lag.

On pages 70 - 71 of her testimony, Ms. Palazzari discusses the premise of adding interest expense to the CWC determination but ultimately decides not to do so. Ms. Palazzari calculated a theoretical interest expense lead of 30.5 days while Mr. Smith calculated a theoretical interest expense lead of 90.75 days on page 38 of his testimony. Both Ms. Palazzari and Mr. Smith cited the same source of information as the basis for their interest expense lead day estimates yet calculated vastly different interest expense lead days.

Q. Did Mr. Smith recommend including long-term interest expense in the CWC requirement in ENSTAR's last rate case, Docket U-16-066?

A. No. Mr. Smith's recommendation in the current case differs from his testimony in ENSTAR's last rate case, Docket U-16-066. In fact, in Docket U-16-066, Mr. Smith recommended removing "Debt Expense from Working Capital" on page 3 of Exhibit

RCS-3 to his testimony in that rate case.[5]

Q. What is the total amount of "non-cash expense" that Mr. Smith recommends be excluded from ENSTAR's CWC requirement?

A. Mr. Smith recommends excluding $39.1 million of what he refers to as "non-cash expense" from ENSTAR's CWC requirement as shown on page 2 of Exhibit RCS-2.

Q. You previously testified that 11.7% of "non-cash expense" has not been collected from customers. Based upon this testimony, how much of the $39.1 million of "non-cash expense" that Mr. Smith recommends excluding from ENSTAR's CWC requirement remains uncollected?

A. About $4.6 million (11.7% x $39.1 million) of the "non-cash expense" Mr. Smith recommends excluding from ENSTAR's CWC requirement remains uncollected.

Q. If $4.6 million of the "non-cash expense" Mr. Smith recommends excluding from ENSTAR's CWC requirement remains uncollected, can ENSTAR pay interest expense?

A. No, not without investors supplying additional working capital. Mathematically, assigning a zero lead day to a cost of service line item, such as "non-cash expense," recognizes that it has not yet been collected from customers due to the known revenue lag (i.e., 42.8 days). According to Mr. Smith's CWC requirement recommendation, ENSTAR has about $3.8 million of interest expense. If $4.6 million of "non-cash expense" remains uncollected, ENSTAR would not have enough cash to pay $3.8 million of interest expense without investors supplying additional working capital

[5] *See* Prefiled Testimony of Ralph C. Smith, page 2 of Exhibit RCS-25 filed in this case, which shows that interest expense was not included by Mr. Smith in the prior case. Although Mr. Smith recommended removing "Debt Expense from Working Capital" in the last case, the Company's witness had not recommended its inclusion.

based on Mr. Smith's recommendation.

IV. MR. SMITH'S PORTRAYAL OF OTHER LEAD-LAG STUDIES

Q. Mr. Smith's Exhibits RCS-9 through RCS-21 to his testimony contain excerpts from other utilities' rate filings in other states. Do Exhibits RCS-9 through RCS-21 support Mr. Smith's recommended adjustments to ENSTAR's CWC requirement?

A. No. Each of Mr. Smith's Exhibits RCS-9 - RCS-21 is nothing more than an incomplete copy of another person's estimate of another utility's working capital requirement. The facts regarding each filing are not known, and the circumstances impacting the recommended working capital requirements are not known. Mr. Smith's Exhibits RCS-9 - RCS-21 do not summarize regulatory policy in those jurisdictions, nor do they present a broad range of opinion as many, if not all, appear to be from the same individual. There are cases from only seven jurisdictions included in Mr. Smith's Exhibits RCS-9 - RCS-21, and many are from jurisdictions considered by investors to be the highest risk regulatory environments based on S&P Global Market Intelligence's comparative analysis of state utility regulatory climates.[6] Four of Mr. Smith's Exhibits RCS-9 - RCS-21 depict Arizona, one portrays Pennsylvania, one depicts New Jersey, one shows Nevada, four portray Missouri, one depicts Kansas, and one shows Oklahoma, respectively.

Each of the seven jurisdictions included in Mr. Smith's Exhibits RCS-9 - RCS-

[6] S&P Global Market Intelligence "maintains three principal rating categories, Above Average, Average, and Below Average, with Above Average indicating a relatively more constructive, lower-risk regulatory environment from an investor viewpoint, and Below Average indicating a less constructive, higher-risk regulatory climate from an investor viewpoint. Within the three principal rating categories, the numbers 1, 2, and 3 indicate relative position. The designation 1 indicates a stronger (more constructive) rating; 2, a mid range rating; and, 3, a weaker (less constructive) rating. We endeavor to maintain an approximately equal number of ratings above the average and below the average."

21 has its own unique regulatory policies. For example, each of the seven jurisdictions uses an end of year rate base instead of average rate base. Some allow the use of projected rate years, or projected test periods, for both cost of service and rate base. Some also allow capital tracker riders (i.e., infrastructure investments without a full rate case) and numerous pass throughs and/or normalization adjustments between rate cases. Many of these aforementioned unique regulatory policies are not available to ENSTAR.

Some of the studies included in Mr. Smith's Exhibits RCS-9 - RCS-21 also show recommendations that are contrary to stated commission decisions in those jurisdictions. For example, Mr. Smith included Exhibit RCS-14 to demonstrate that "the utility's calculation of the cash working capital allowance includes the interest expense payment on long term debt" as stated on page 54. However, the CWC recommendation depicted on Exhibit RCS-14 includes the interest expense payment on long-term debt which is contrary to commission precedent in New Jersey:

> The return on investment is the property of investors when service is provided. Payment from operating income for long and short term debt, preferred stock and common stock dividends require a zero payment lag because the funds used to render these payments are the property of investors of a utility.[7]

[7] I/M/O Atlantic City Electric Company, BPU Docket No. 8310883, OAL Docket No. 8543-83 (1984). For additional examples see I/M/O Public Service Electric and Gas Company, BPU Docket No. 837-620 (1984); I/M/O Middlesex Water Company for Approval of an Increase in its Rates for Water Service and Other Tariff Changes, OAL Docket No. PUC 4879-00, BPU Docket No. WR00060362 (2001); and I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, OAL Docket No. PUC 09366-02, Board Docket No. ER02100724 (2003).

V. MR. SMITH'S INCONSISTENCIES

Q. Is Mr. Smith consistent with his recommendations for ENSTAR's CWC requirement?

A. No. Mr. Smith is not consistent with his recommendations for ENSTAR's CWC requirement. Below is a summary of some of Mr. Smith's inconsistencies:

- Mr. Smith only recommends adjusting the revenue billing lag days while ignoring the expense billing lag days.
- Mr. Smith's recommended revenue billing lag is based on 2015 data while the rest of his recommendations are based on 2021 data.
- Mr. Smith recommends using the "due date" for some ad valorem taxes while ignoring the "due dates" for other expense line items.
- Mr. Smith did not recommend including interest expense lead days in ENSTAR's last rate case but now recommends including interest expense lead days in ENSTAR's current rate case.

VI. RESULTS OF THE UPDATE

Q. What are the results of updating Schedule HW-1 to reflect changes to the Company's test year amounts?

A. Updated Schedule HW-1 summarizing ENSTAR's CWC requirements is simply an update of Schedule HW-1 from my direct testimony. Updated Schedule HW-1 reflects the Company's agreed-to changes to the Company's test year classification of earthquake amortization. Specifically, the Company agreed with RAPA to reclassify earthquake amortization in depreciation expense instead of administrative and general expenses as explained in the Prefiled Reply Testimony of Ms. Guintu. The updated

CWC requirement for ENSTAR is $9,846,197 as shown on Updated Schedule HW-1 attached to my reply testimony as Exhibit HW-3.

Q. Does this conclude your Prefiled Reply Testimony?

A. Yes, it does.

ENSTAR Natural Gas Company
Summary Calculation of Cash Working Capital Requirements
Based on Lead-Lag Study For the Twelve Months Ended December 31, 2021

Line	Description	Test Year Amount	Average Daily Amount	Revenue Lag	Lag Ref.	Expense Lead	Lead Ref.	Net (Lead)/Lag Days	Working Capital Requirement
1	Operations and Maintenance Expenses								
2	Purchased Gas Costs	$ 271,695,303	$ 744,371	42.80	(1)	39.30	(3)	3.50	$ 2,605,297
3	Non-Gas Operation and Maintenance Expenses								
4	Payroll Expenses	17,602,827	48,227	42.80	(1)	34.00	(3)	8.80	424,397
5	Affiliate Charges	4,597,389	12,596	42.80	(1)	35.00	(3)	7.80	98,246
6	Other Third-Party O&M Expenses	15,480,893	42,413	42.80	(1)	21.30	(3)	21.50	911,888
7	Uncollectible Accounts Expense	947,710	2,596	42.80	(1)	0.00	(3)	42.80	111,129
8	Total O&M Expenses	$ 310,324,121	$ 850,203						$ 4,150,957
9	Income Taxes								
10	Current Federal Income Taxes	$ 4,659,437	$ 12,766	42.80	(1)	36.50	(3)	6.30	$ 80,423
11	Deferred Federal Income Taxes	(992,935)	(2,720)	42.80	(1)	0.00	(3)	42.80	(116,432)
12	State Income Tax	2,613,064	7,159	42.80	(1)	36.50	(3)	6.30	45,102
13	Total Federal Income Taxes	$ 6,279,566	$ 17,204						$ 9,094
14	Taxes Other Than Income Taxes								
15	Ad Valorem Taxes	$ 4,511,377	$ 12,360	42.80	(1)	(21.50)	(3)	64.30	$ 794,744
16	Total Taxes Other Than Income Taxes	$ 4,511,377	$ 12,360						$ 794,744
17	Depreciation Expense	$ 18,951,338	$ 51,921	42.80	(1)	0.00	(3)	42.80	$ 2,222,239
18	Utility Operating Income	$ 24,368,575	$ 66,763	42.80	(1)	0.00	(3)	42.80	$ 2,857,466
19	Subtotal	$ 364,434,978							$ 10,034,499
20	Other Adjustments								
21	Local Sales Tax	$ 1,499,362	$ 4,108	23.30	(2)	57.60	(3)	(34.30)	$ (140,899)
22	Regulatory Charge	364,259	998	23.30	(2)	70.80	(3)	(47.50)	(47,404)
23	Total Other Adjustments	$ 1,863,621	$ 5,106						$ (188,303)
24	Total Cash Working Capital Requirement								$ 9,846,197

Notes: (1) See page 1 of Schedule HW-2 for total revenue lag days.
(2) See page 3 of Schedule HW-2 for total revenue collection lag days.
(3) See page 1 of Schedule HW-3 for lead days.